

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1940

No. 486

MADELEINE D. POWERS, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

**ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE FIRST CIRCUIT**

PETITION FOR CERTIORARI FILED OCTOBER 7, 1940.

CERTIORARI GRANTED NOVEMBER 12, 1940.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 486

MADELEINE D. POWERS, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE FIRST CIRCUIT

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UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

OCTOBER TERM, 1939.

No. 3546.

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER FOR REVIEW,

v.

MADELEINE D. POWERS.

PETITION FOR REVIEW OF DECISION OF UNITED STATES
BOARD OF TAX APPEALS.
DECISION, JANUARY 9, 1940.

RECORD ON PETITION FOR REVIEW.

SAMUEL O. CLARK, JR.,
ASSISTANT ATTORNEY GENERAL,
SEWALL KEY,
SPECIAL ASSISTANT TO THE ATTORNEY GENERAL,
for Petitioner.

RALPH G. BOYD,
ROGER E. ELA,
NUTTER, McCLENNEN & FISH,
for MADELEINE D. POWERS.

BOSTON:
PRINTED UNDER DIRECTION OF THE CLERK.
1940

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

OCTOBER TERM, 1939.

No. 3546.

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER FOR REVIEW,

v.

MADELEINE D. POWERS

RECORD ON PETITION FOR REVIEW.

[FILED IN CIRCUIT COURT OF APPEALS DECEMBER 5, 1939.]

DOCKET No. 88229.

MADELEINE D. POWERS, PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

APPEARANCES.

For Taxpayer:

Ralph G. Boyd, Esq.

For Commissioner:

J. D. Head, Jr., Esq.

B. W. Royce, Esq.

DOCKET ENTRIES.

1937.

Feb. 26 - Petition received and filed. Taxpayer notified. (Fee paid)

" 26 - Copy of petition served on General Counsel.

Apr. 14 - Answer filed by General Counsel.

" 16 - Copy of answer served on taxpayer.

Oct. 26 - Motion for circuit hearing at Boston, Mass. filed by taxpayer. 10/27/37 granted.

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Mar. 4 - Hearing set May 9, 1938 at Boston, Mass.

May 16 - Hearing had before Mr. Sternhagen on merits. Submitted. Stipulation of facts filed. Petitioner requests for rulings of law filed. Briefs due as per rules.

" 27 - Transcript of hearing of May 16, 1938 at Boston, Mass. filed.

Jun. 15 - Brief filed by taxpayer. 6/16/38 copy served.

Jul. 25 - Motion for leave to file the attached brief, brief lodged, filed by General Counsel. 7/26/38 granted.

Aug. 10 - Reply brief filed by taxpayer. 8/10/38 copy served.

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Jan. 9 - Memorandum findings of fact and opinion rendered, John M. Sternhagen, Div. 10. Decision will be entered for the petitioner.

" 9 - Decision entered, J. M. Sternhagen, Div. 10.

Mar. 29 - Petition for review by U. S. Circuit Court of Appeals (1) with assignments of error filed by General Counsel.

Apr. 7 - Proof of service filed by General Counsel. Taxpayer & Attorney.

May 23 - Motion for extension of time to July 27, 1939 to transmit and complete the record filed by General Counsel.

" 23 - Order enlarging time to July 27, 1939 to prepare and transmit record entered.

Jul. 24 - Motion for extension to Sept. 26, 1939 to prepare and transmit record filed by General Counsel.

" 24 - Order enlarging time to Sept. 26, 1939 to prepare and transmit record entered.

Sep. 20 - Motion for extension to Nov. 25, 1939 to complete and transmit record filed by General Counsel.

" 20 - Order enlarging time to Nov. 25, 1939 to complete and transmit record entered.

Nov. 17 - Certified copy of an order from U. S. Circuit Court of Appeals, 1st Circuit, granting the transfer of certain

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physical exhibits in lieu of reproduction thereof in the printed record filed.

Nov. 21 - Motion for extension to 12/28/39 to prepare evidence and transmit record filed by General Counsel.

" 21 - Order enlarging time to 12/28/39 to prepare and transmit record entered.

" 28 - Agreed statement of evidence lodged.

" 28 - Praecept for record filed with proof of service thereon. No counter praecept to be filed.

" 29 - Agreed statement of evidence approved and ordered filed:

[Title omitted.]

PETITION.

[Filed February 26, 1937.]

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (MT-ET-GT-758-35-Massachusetts) dated November 30, 1936, and as a basis of this proceeding alleges as follows:

1. The petitioner is an individual whose address is 316 Beacon Street, Boston, Massachusetts.

2. The notice of deficiency, a copy of which is hereto attached and marked "Exhibit A", was mailed to the petitioner on November 30, 1936.

3. The taxes in controversy are gift taxes for the calendar year 1935 in the sum of \$4,134.52.

4. The determination of the taxes set forth in said notice of deficiency is based upon the following error:

The adoption of a basis of valuation based on costs rather than actual value at the date of the gift.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

The petitioner at various dates in December, 1935, made gifts of six insurance policies and reported such gifts in Form 709

Record on Petition for Review.

setting forth as the value thereof the values of the respective policies at the respective dates of gift as follows:

Item 1	\$12,360.00
Item 2	56,198.86
Item 3	23,271.30
Item 4	84,067.70
Item 5	20,790.73
Item 6	36,671.71

The determination of values upon which said deficiency is based is as follows:

Item 1	\$13,967.40
Item 2	68,779.00
Item 3	27,204.80
Item 4	99,672.78
Item 5	22,671.60
Item 6	40,854.00

Under the provisions of Section 506 of the Revenue Act of 1932 as amended, the applicable statute, "If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift." The reported values, being the values at the respective dates of the gifts, are controlling and the provisions of Article 19(9) of the Regulations 79 as amended, even if in effect and otherwise applicable to the gifts here in question and purporting to require a basis of valuation based on cost rather than actual value at the date of the gifts, are not, in view of the clear and express provisions of the statute, a proper basis for changing the values reported by the petitioner.

Wherefore the petitioner prays that this Board may hear the proceedings with reference to the respondent's notice of deficiency and may determine that there is no deficiency.

RALPH G. BOYD,

Counsel for Petitioner,

161 Devonshire Street,

Boston, Massachusetts.

COMMONWEALTH OF MASSACHUSETTS,
COUNTY OF SUFFOLK, SS.

John M. Dry, being duly sworn, says that he is an attorney in fact of the petitioner above named; that the petitioner is at present sojourning outside the United States; that Exhibit B attached to this petition is a copy of the power of attorney under which he acts, that he acts under such power, that such power has not been revoked, that the petitioner is absent from the United States and that the grounds of his knowledge of the facts alleged in the petition are personal knowledge of the facts and personal examination of the papers involved; that he has read the foregoing petition and is familiar with the statements contained therein, and that the facts stated are true.

JOHN M. DRY.

Subscribed and sworn to before me this twenty-fifth day of February, 1937.

EDWARD WILLIAMSON,

[SEAL]

Notary Public.

My commission expires December 23, 1937.

EXHIBIT A.

TREASURY DEPARTMENT WASHINGTON
Office of Commissioner of Internal Revenue

Address reply to Commissioner of Internal Revenue and Refer
To MT-ET-GT-758-35-Massachusetts Donor—Madeleine D.
Powers

Nov. 30, 1936

Mrs. Madeleine D. Powers, 316 Beacon Street, Boston, Massachusetts.

Madam: A deficiency of \$4,134.52 in your Federal gift tax liability for the calendar year 1935 has been determined after a review of the file in the case and a consideration of the protest against a deficiency proposed in a previous letter from this office.

The determination of the deficiency and the action of this office on the protest are fully explained in the attached statement.

This notice of deficiency is given in accordance with provisions of Section 513(a) of the Revenue Act of 1932 as amended by Section 501 of the Revenue Act of 1934, and a petition for a redetermination of the deficiency may be filed with the United States Board of Tax Appeals within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter. If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute and forward the enclosed Form 890A, waiving the restrictions on the immediate assessment and collection of the deficiency.

The submission of the waiver will expedite the closing of this case and will also benefit you by preventing the accumulation of interest charges, as the interest period terminates 30 days after the filing of the waiver or on the date of assessment, whichever is earlier. The signing of the waiver does not prejudice your right to file a claim for refund of all or any portion of the tax. If you desire to consent to the assessment and collection of only a part of the deficiency, the enclosed form of waiver should be executed in such partial amount.

If within the 90-day period a petition has not been filed with the United States Board of Tax Appeals or the waiver, Form 890A, has not been submitted, the deficiency will be thereafter assessed.

Respectfully,

GUY T. HELVERING, Commissioner.

By: D. S. Bliss, Deputy Commissioner.

Enclosure: Waiver, Form 890A

MT-ET-GT-758-35-Massachusetts

Donor—Madeleine D. Powers

STATEMENT

In Bureau letter of July 7, 1936, a deficiency of \$4,134.52 in your Federal gift tax liability was tentatively determined for the calendar year 1935.

Your protest, which was made the subject of a conference in this office on September 30, 1936, with your representative, is directed against the values tentatively determined for the following mentioned single premium insurance policies which you transferred by gift on December 30, 1935 and December 31, 1935:

Schedule A—1935 Return

- Item 1—Policy No. 532838—The Fidelity Mutual Life Ins., Co.
—Date of issue—November 25, 1935.
- Item 2—Policy No. 9114410—The Prudential Ins. Co. of America—Date of issue—December 4, 1935.
- Item 3—Policy No. 5090777—The Mutual Life Insurance Co. of N. Y.—Date of issue—November 25, 1935.
- Item 4—Policy No. 9114963—The Prudential Insurance Co. of America—Date of issue—December 5, 1935.
- Item 5—Policy No. 887777—The Connecticut Mutual Life Ins. Co.—Date of issue—November 27, 1935.
- Item 6—Policy No. 435395—Home Life Insurance Company—
Date of issue—November 27, 1935.

Article 19(9) of Regulations 79, 1935 Edition, relating to gift tax under the Revenue Act of 1932, as amended and supplemented by the Revenue Acts of 1934 and 1935, provides that where a donor, owning a life insurance policy on which no further payments are to be made to the company, for example, a single premium policy or paid-up policy, makes a gift of the contract, the value of the gift is the amount which the company would charge for a single premium contract of the same specified amount on

the life of a person of the age of the insured. Since your age was the same on the dates of the respective gifts of the insurance policies as on the dates of issue, the values for gift tax purposes are the costs of such policies to you. Your protest is accordingly denied and the tentative findings are hereby made final as explained in the following computation:

Schedule A—1935

	Returned	Tentatively Determined
Item 1	\$12,360.00	\$13,967.40
Item 2	56,198.86	68,779.00
Item 3	23,271.30	27,204.80
Item 4	84,067.70	99,672.78
Item 5	20,790.73	22,671.60
Item 6	36,671.71	40,854.00
Item 7	1,047.50	1,047.50
Total gifts, 1935	\$234,407.80	\$274,197.08
Less: Exclusion	5,747.69	5,747.69
Included amount of gifts	\$228,660.11	\$268,449.39
Less: Specific exemption	50,000.00	50,000.00
Net gifts, 1935	\$178,660.11	\$218,449.39
Tax on net gifts	\$11,279.41	\$15,413.93
Tax assessed on return		11,279.41
Deficiency, 1935		\$4,134.52

The deficiency bears interest at the rate of six per cent per annum from the due date of the tax, March 15, 1936, to the date of assessment, or to the thirtieth day after the filing of a waiver of the restrictions on the assessment, whichever is the earlier.

EXHIBIT B.

Know all men by these Presents, that I, Madeleine D. Powers, of Boston, Massachusetts, hereby revoking all previous powers of attorney, do hereby make, constitute and appoint Ralph G. Boyd, Allison L. Newton, John M. Dry and any member of the firm of

Nutter, McClennen & Fish, all of Boston, and each of them separately; my true and lawful attorneys for me, and in my name, place and stead to prosecute, defend, adjust, settle and compromise all claims of the United States and/or the Commonwealth of Massachusetts against me for taxes and all claims by me against the United States and/or the Commonwealth of Massachusetts for abatement, credit or refund of any taxes erroneously assessed or collected, and in my behalf and in my name and stead to execute, make oath to and file any and all claims for abatement and/or credit and/or refund of, and/or returns relating to taxes imposed by the United States and/or the Commonwealth of Massachusetts, to institute suits, attend all conferences and hearings before Bureaus of the United States and/or the Commonwealth of Massachusetts, to inspect all tax returns, reports and any other papers on file with such Bureaus, relating thereto, giving and granting unto my said attorneys and each of them full power and authority to do and perform every act and thing requisite, necessary and proper to be done in the premises as fully to all intents and purposes as I might or could do, with full power of substitution and revocation.

In witness whereof, I have hereunto set my hand and seal this 1st day of August, 1936.

MADELEINE D. POWERS (SEAL)

State of Maine.

County of York.

August 1st, 1936.

Then personally appeared Madeleine D. Powers to me personally known, who acknowledged this instrument to be her free act and deed.

Before me,

Walter L. Goodwin,

(NOTARIAL SEAL)

Notary Public.

My Commission Expires Sept. 14, 1939

[Title omitted.]

ANSWER.

[Filed April 14, 1937.]

The Commissioner of Internal Revenue, by his attorney, Morrison Shafroth, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1, 2 and 3. Admits the allegations contained in paragraphs 1, 2 and 3 of the petition.

4. Denies the Commissioner erred as alleged in paragraph 4 of the petition. Denies the Commissioner committed any error in the determination of the deficiency.

5. Admits so much of paragraph 5 of the petition as alleges that the petitioner at various dates in December, 1935, made gifts of six insurance policies and reported such gifts in Form 709 setting forth as the value thereof the values of the respective policies at the respective dates of gift as follows:

Item 1	\$12,360.00
Item 2	56,198.86
Item 3	23,271.30
Item 4	84,067.70
Item 5	20,790.73
Item 6	36,671.71

Admits further that the determination of values upon which said deficiency is based is as follows:

Item 1	\$13,967.40
Item 2	68,779.00
Item 3	27,204.80
Item 4	99,672.78
Item 5	22,671.60
Item 6	40,854.00

Denies the remaining allegations contained in said paragraph.

6. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied:

Wherefore it is prayed that the determination of the Commissioner be approved.

MORRISON SHAFROTH,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

FRANK T. HORNER,
Special Attorney,
Bureau of Internal Revenue.

[Title omitted.]

STIPULATION OF FACTS.

[Filed at Hearing May 16, 1938.]

It is hereby stipulated and agreed by and between the parties hereto through their respective attorneys of record that for the purpose of this proceeding only the following facts may be taken as true, without prejudice to the right of either party to introduce further testimony at the hearing of this case:

1. Madeleine D. Powers, the petitioner herein, purchased from the insurance companies listed below single premium policies of life insurance as follows:

Record on Petition for Review.

Date of Issue of Policy	Name of Insurance Company	Policy Number	Name of Insured	Face Amount of Policy	Amount of Single Premium Paid
Nov. 25, 1935	The Fidelity Mutual Life Ins. Co.	532838	Madeleine D. Powers	\$20,000.00	\$13,967.40
Dec. 4, 1935	The Prudential Insurance Co. of America	9114410	Madeleine D. Powers	100,000.00	68,779.00
Nov. 25, 1935	The Mutual Life Insurance Co. of N. Y.	5090777	Madeleine D. Powers	40,000.00	27,204.80
Dec. 5, 1935	The Prudential Insurance Co. of America	9114963	Madeleine Powers	122,000.00	99,672.78
Nov. 27, 1935	The Connecticut Mutual Life Ins. Co.	887777	Madeleine Powers	28,000.00	22,671.60
Nov. 27, 1935	Home Life Insurance Company	435395	Madeleine Powers	50,000.00	40,854.00

It is agreed that the petitioner will offer in evidence at the hearing of this cause photostatic copies of said insurance policies and said photostatic copies may be received in evidence in lieu of the original policies.

2. At various dates in December, 1935, the petitioner made gifts of the life insurance policies listed in paragraph 1 of this stipulation as follows:

Date of Gift	Name of Insurance Company	Policy Number	Name of Insured
Dec. 30, 1935	The Fidelity Mutual Life Ins. Co.	532838	Madeleine D. Powers
Dec. 30, 1935	The Prudential Insurance Co. of America	9114410	Madeleine D. Powers
Dec. 30, 1935	The Mutual Life Insurance Co. of N. Y.	5090777	Madeleine D. Powers
Dec. 30, 1935	The Prudential Insurance Co. of America	9114963	Madeleine Powers
Dec. 30, 1935	The Connecticut Mutual Life Ins. Co.	887777	Madeleine Powers
Dec. 31, 1935	Home Life Insurance Company	435395	Madeleine Powers

3. It is agreed that during the period from November 25, 1935 to December 31, 1935 there had been no sufficient change in the age of the insured in any of the policies listed in paragraph 1 of this stipulation which would have required the payment of a single premium larger than those set forth in paragraph 1 for the issuance of like policies of life insurance during that period.

4. It is agreed that the cash surrender values and the reserves carried by the insurance companies in respect to the policies of life insurance listed in paragraph 1 of this stipulation on the respective dates of gift are as set forth in the following table:

Name of Insurance Company	Policy Number	Date of Gift	Cash Surrender Value on Date *of Gift	Reserve Carried By Insurance Company at Date of Gift
The Fidelity Mutual Life Ins. Co.	532838	Dec. 30, 1935	\$12,360.00	\$12,672.02
The Prudential Insurance Co. of America	9114410	Dec. 30, 1935	56,198.86	60,917.84
The Mutual Life Insurance Co. of N. Y.	5090777	Dec. 30, 1935	23,271.30*	25,344.05
The Prudential Insurance Co. of America	9114963	Dec. 30, 1935	84,067.70	89,383.33
The Connecticut Mutual Life Ins. Co.	887777	Dec. 30, 1935	20,790.73	21,126.73
Home Life Insurance Company	435395	Dec. 31, 1935	30,671.71	37,728.33

* Cash surrender value when right to surrender first arose, discounted to date of gift.

5. At the respective dates of gift there were no accumulated dividends apportioned or credited, provisionally or otherwise, to, and no paid-up additions to, any of said policies.

6. It is agreed that for the purpose of this proceeding the Board may take judicial notice of the American Experience Table of Mortality.

7. On March 11, 1936 the petitioner filed with the Collector of Internal Revenue at Boston, Massachusetts a federal gift tax return for the calendar year 1935. It is agreed that the respondent will offer said federal gift tax return in evidence at the hearing of this cause, and that respondent may withdraw the said federal gift tax return from the Board's files and substitute a photostatic copy therefor.

8. On November 30, 1936, within the statutory period of limitation, the respondent sent to the petitioner by registered mail a notice of deficiency a true copy of which is attached to the petition herein as "Exhibit A".

RALPH L. BOYD,

Attorney for Petitioner.

J. P. WENCHEL, w

Counsel for Respondent.

UNITED STATES BOARD OF TAX APPEALS.

Madeleine D. Powers, Petitioner,

v.

Commissioner of Internal Revenue, Respondent.

Docket No. 88229.

RALPH G. BOYD, Esq., for the petitioner.

JAMES D. HEAD, Jr., Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION.

Entered January 9, 1939.

Respondent determined a deficiency of \$4,134.52 in petitioner's gift tax for 1935. Petitioner assails the use of the cost of six single premium insurance policies as their values for purposes of gift tax.

FINDINGS OF FACT.

In November and December, 1935, petitioner, a resident of Boston, Massachusetts, purchased six single premium policies of insurance, as follows:

Company and Policy Number	Date of Issue of Policy	Name of Insured	Face Amount of Policy	Amount of Single Pre- mium Paid	Type of Policy
The Fidelity Mutual Life Ins. Co. No. 532838	11/25/35	Madeleine D. Powers	\$20,000	\$13,967.40	Ordinary Life
The Prudential Ins. Co. of America No. 9114410	12/4/35	Madeleine D. Powers	100,000	68,779.00	Ordinary Life
The Mutual Life Ins. Co. of N. Y. No. 5090777	11/25/35	Madeleine D. Powers	40,000	27,204.80	Ordinary Life
The Prudential Ins. Co. of America No. 9114963	12/5/35	Madeleine Powers	122,000	99,672.78	10-Yr. Endowment
The Connecticut Mutual Life Ins. Co. No. 887777	11/27/35	Madeleine Powers	28,000	22,671.60	10-Yr. Endowment
Home Life Ins. Co. No. 435395	11/27/35	Madeleine Powers	50,000	40,854.00	10-Yr. Endowment

In December, 1935 petitioner made gifts of the policies having a cash surrender value and reserve carried against them on the date of gift, as follows:

Company and Policy Number	Date of Gift	Cash Surrender Value on Date of Gift	Reserve Carried by Ins. Co. at Date of Gift
The Fidelity Mutual Life Ins. Co. No. 532838	12/30/35	\$12,360.00	\$12,672.02
The Prudential Ins. Co. of America No. 9114410	12/30/35	56,198.86	60,917.84
The Mutual Life Ins. Co. of N. Y. No. 5090777	12/30/35	23,271.30*	25,344.05
The Prudential Ins. Co. of America No. 9114963	12/30/35	84,067.70	89,383.33
The Connecticut Mutual Life Ins. Co. No. 887777	12/30/35	20,790.73	21,126.73
Home Life Ins. Co. No. 435395	12/31/35	36,671.71	37,728.33

*Cash surrender value when right to surrender first arose, discounted to date of gift.

The policies in which petitioner was named as the insured were payable at the outset to petitioner's husband, George H. Powers, if living, and the policies in which her daughter, Madeleine Powers, was named as the insured were payable to petitioner if living, otherwise to the insured, the estate of the insured, or the estate of petitioner. Petitioner retained the right to change the beneficiaries of the policies in which she was named as the insured. The gifts were in the form of irrevocable assignments to petitioner's husband and the Massachusetts Hospital Life Insurance Co., as trustees. At the time of the issuance of the policies petitioner was fifty-seven and her daughter twenty-one years of age. During the period from November 25 to December 31, 1935, there was not a sufficient change in the age of the insured in any of the policies to require, for the issuance of like policies during that period, the payment of larger single premiums than those paid by petitioner. At the respective dates of gift there were no accumulated dividends apportioned or credited to any of the policies, provisionally or otherwise, and no paid-up additions to the policies. In calculating the reserves in this case the companies used the American Experience Table of Mortality with 3 per cent or $3\frac{1}{2}$ per cent interest.

In the case of a single premium policy the cash surrender value during the first year in which the policy is outstanding is always less than the reserve. The cash surrender value is the reserve for

the policy less a surrender charge, and varies with the different companies and policy years. The surrender charge and premiums actually paid in the particular year account for the difference between the reserve and cash surrender value on a particular policy. The discouragement of surrenders is one of the reasons for the surrender charge. Part of the surrender charge is placed in a contingency reserve to meet adverse mortality and interest expense over a period of years.

Premium exceeds the reserve at the outset by the amount of expenses which include commissions, taxes, medical fees, cost of issuing the policy and placing it on the books, and the inspection fee.

With respect to Prudential Policy No. 9114410, interpolating between the initial reserve of \$60,833 for \$100,000 of insurance at the age of fifty-seven and \$62,024, the terminal reserve, at the age of fifty-eight, the total interpolated reserve as of December 30, 1935, twenty-six days after the issuance of the policy, was \$60,917.84. The single premium charged at the outset, \$68,779, included the amount necessary to maintain the company's reserves, plus all costs of management and commissions, commonly called loading charges. On the date of gift none of the companies in this case would have paid to the owner of the policy the amount of the reserve against the policy. The Prudential Insurance Company of America, not having an absolute obligation to pay the cash surrender value during the first year, would have granted the discounted value of the first year cash surrender value, as of the date of the gift. Discounting the cash surrender value at $3\frac{1}{2}$ percent, the amount of the gift in the case of Prudential Policy No. 9114410 would be \$56,076.94.

The six policies here involved are in such form that they could be readily assigned, whether or not the assignee might have an insurable interest. Banks and insurance companies make loans on insurance policies, the latter generally charging a higher rate of interest. To insurance companies the loan value of a policy is equal to its cash surrender value, except that some companies deduct the interest charge from the loan at the start. A bank will

generally loan up to 90 percent of the cash surrender value, and in some cases up to the full cash surrender value.

A bank will not loan in excess of the cash surrender value where the policy is the only collateral. Individuals frequently buy insurance policies for investment but corporations do not.

On March 11, 1936, petitioner filed with the Collector of Internal Revenue at Boston, Massachusetts, a federal gift tax return for the calendar year 1935.

The total value of the gifts when made in 1935 was \$233,360.30.

OPINION.

STERNHAGEN: After reading the stipulation and evidence and considering the briefs of the parties, we are unable to find any reason for arriving at a different conclusion from that reached in *Ernest A. Cronin*, 37 B.T.A. 914, and *Mary H. Haines*, 37 B.T.A. 1013, both of which are now pending on review in the Circuit Court of Appeals for the Third Circuit. The petitioner in her gift tax return valued the gifts at \$233,360.30, the cash surrender value of the policies at that time. The Commissioner increased the value to \$273,149.58 by using the total amount of single premiums paid by petitioner a short time before the gift. The aforesaid decisions held the Commissioner to have been in error in those cases, and we follow them in holding here that the cash surrender value is to be used as the value of the gift.

Enter:

Decision will be entered for the petitioner.

[Title omitted.]

DECISION.

Entered January 9, 1939.

In accordance with the Board's memorandum findings of fact and opinion, entered January 9, 1939, it is

Ordered and decided that there is no deficiency in gift tax for 1935.

Enter:

JOHN M. STERNHAGEN, *Member.*

[Title omitted.]

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR.

[Filed March 29, 1939.]

To the Honorable Judges of the United States Circuit Court of Appeals for the First Circuit:

Now comes Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys, James W. Morris, Assistant Attorney General, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and Ralph F. Staubly, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

That he is the duly appointed, qualified and acting Commissioner of Internal Revenue, appointed and holding office by virtue of the laws of the United States; that Madeline D. Powells (hereinafter referred to as the donor), a citizen of the United States, resides at 316 Beacon Street, Boston, State of Massachusetts; that the donor filed her gift tax return for the calendar year 1935 with the Collector of Internal Revenue for the District of Massachusetts, whose office is located in Boston, Massachusetts, which is within the jurisdiction of the United States Circuit Court of Appeals for the First Circuit.

The court in which the review of this proceeding is sought is the United States Circuit Court of Appeals for the First Circuit.

II.

The nature of the controversy is as follows, to wit:

The gift tax return filed by the donor for the calendar year 1935 disclosed a tax liability of \$11,279.41. The donor included in said return, as the subject of gifts by her to named beneficiaries, certain single premium life insurance policies at a value based upon the cash surrender value of said policies as set forth in the schedule incorporated in each of said policies.

Under date of November 30, 1936 the Commissioner of Internal Revenue mailed a notice to the donor asserting a deficiency in the

gift tax for the calendar year 1935 in the amount of \$4,134.52. In determining said deficiency the Commissioner included said insurance policies in the amount of the total gifts made by the donor at a value representing the cost or premiums payable for such or like policies as of the date of the gifts.

Under date of February 26, 1937, the donor filed a petition with the United States Board of Tax Appeals for a redetermination of the deficiency in the tax above mentioned, and after the answer of the Commissioner of Internal Revenue was duly filed, the case was submitted to the Board of Tax Appeals for decision on the basis of the pleadings, a stipulation of facts and certain exhibits offered and received in evidence and the testimony of sundry witnesses called on behalf of the donor. The memorandum opinion and interlocutory decision was entered January 9, 1939 and the final order of the Board of Tax Appeals, redetermining the deficiency, was entered January 9, 1939, in which it was ordered and decided that there was no deficiency in gift tax for the year 1935.

The Board of Tax Appeals in holding and deciding that there was no deficiency in the tax, as aforesaid, determined that, for the purposes of the tax, the value of the aforesaid single premium life insurance policies, as of the date of the gift, was the value at which said policies were returned by the donor, and which was based upon the cash surrender value thereof.

III:

The Commissioner of Internal Revenue being aggrieved by the conclusions of law contained in the decision of the Board of Tax Appeals and by its order of redetermination, desires to obtain a review thereof by the United States Circuit Court of Appeals for the First Circuit.

The Commissioner's assignments of error are as follows:

1. The Board of Tax Appeals erred in holding and deciding and finding as a fact that the fair market value for gift tax purposes of single premium insurance policies was the cash surrender value thereof as of the date of the gift of such policies; there being no substantial evidence to support such finding of fact.

2. The Board of Tax Appeals erred in not holding and deciding and finding as a fact that the fair market value for gift tax purposes of single premium life insurance policies was not the cash surrender value thereof as of the date of the gift.

3. The Board of Tax Appeals erred in holding and deciding and finding as a fact that the fair market value for gift tax purposes of single premium life insurance policies was not the amount of the premium payable for such or like policies as of the date of the gift.

4. The Board of Tax Appeals erred in not holding and deciding and finding as a fact that the fair market value for gift tax purposes of single premium life insurance policies was the amount of the premiums payable for such or like policies as of the date of the gift; as shown and established by the evidence adduced.

5. The Board of Tax Appeals erred in entering its final order of redetermination that there is no deficiency in gift tax for the calendar year 1935, instead of a deficiency of \$4,134.52, as determined by the Commissioner.

6. The Board of Tax Appeals erred in failing and refusing to enter a final order of redetermination that there is a deficiency in gift tax for the calendar year 1935 in the amount of \$4,134.52, as determined by the Commissioner, instead of no deficiency in the gift tax.

Wherefore, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the First Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said court and transmitted to the clerk of said court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said court.

JAMES W. MORRIS,

Assistant Attorney General.

J. P. WENCHEL, RLW,

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

RALPH F. STAUBLY,

Special Attorney, Bureau of Internal Revenue.

UNITED STATES OF AMERICA,

DISTRICT OF COLUMBIA, ss.

Ralph F. Staubly, being duly sworn, says that he is a special attorney in the Bureau of Internal Revenue, and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

RALPH F. STAUBLY,

Special Attorney.

Sworn and subscribed to before me this twenty-eighth day of March, 1939.

GEORGE W. KRIES,

Notary Public.

My commission expires November 15, 1942.

[Title omitted.]

NOTICE OF FILING PETITION FOR REVIEW.

[Filed April 7, 1939.]

To RALPH G. BOYD, Esq., 161 Devonshire Street, Boston, Massachusetts:

You are hereby notified that the Commissioner of Internal Revenue did, on the twenty-ninth day of March, 1939, file with the clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the First Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this twenty-ninth day of March, 1939.

J. P. WENCHEL, RLW,

Chief Counsel, Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this first day of April, 1939.

RALPH G. BOYD,

Attorney for Respondent on Review.

[Title omitted.]

NOTICE OF FILING PETITION FOR REVIEW.

[Filed April 7, 1939.]

To Mrs. MADELINE D. POWERS, 316 Beacon Street, Boston, Massachusetts:

You are hereby notified that the Commissioner of Internal Revenue did, on the twenty-ninth day of March, 1939, file with the clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the First Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this twenty-ninth day of March, 1939.

J. P. WENCHEL, RLW,

Chief Counsel, Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this third day of April, 1939.

MADELINE D. POWERS,

Respondent on Review.

[Title omitted.]

STATEMENT OF EVIDENCE.

[Filed November 29, 1939.]

The following is a statement of evidence in narrative form in the above-entitled cause. This cause came on for hearing before the Honorable John M. Sternhagen, member of the United States Board of Tax Appeals, on May 16, 1938. Ralph G. Boyd, Esq., appeared for the petitioner (respondent on review), and J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, by James D. Head, Jr., Esq., appeared for the Commissioner of Internal Revenue.

In addition to the testimony, there was a stipulation of facts, that is being made a part of the record on appeal.

At the hearing, before any witness was called, it was agreed that the only question in controversy is as to the proper method of arriving at the values to be used as the measure of the gift tax with reference to a gift of certain life insurance policies. Before any witness was called, the following exhibits were introduced in evidence:

[Petitioner's Exhibits 1 to 6 inclusive—the life insurance policies involved.]

[Respondent's Exhibit A—Gift tax return covering the gift involved.]

Photostatic copies of all of the foregoing exhibits are attached hereto.

Thereupon DONALD B. CHENEY, a witness called on behalf of the petitioner, after being first duly sworn, testified as follows:

I live at 21 Bodwell Terrace, Millvale, New Jersey. I am employed by the Prudential Insurance Company of America at their home office in Newark, New Jersey, and I am a mathematician in the Actuarial Department of that company. I have examined the two Prudential policies and the other policies involved in this proceeding. I have been employed in the Actuarial Department of the Prudential for thirteen years. During that time I have become

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a Fellow, by examination, of the American Institute of Actuaries and also the Actuarial Society of America.

I am familiar with the practice in setting up reserves for life insurance policies and in particular on single-premium life policies and ten-year endowment policies. Ordinarily, the reserve under a policy is that amount which, if invested now, must be sufficient at some future time to pay the death claim under that policy, or to members of that group of policies, as such claims become due.

The entire premium paid by an insured on the issuance of a policy is termed the gross or office premium, and is composed of two parts:

"The one part constitutes the loading, for expenses, such as commissions, taxes, medical fee, cost of issuing policy and placing it on the books, inspection fee, and so forth. The other part of the premium is used to set up the reserve under the policy, and that premium must be based on a certain mortality table, and a certain assumed rate of interest that is going to be earned under the policy. That is, the net single premium is to be invested at a certain rate of interest in order to pay the benefits as they fall due in the future."

Ordinarily, the American Experience Table of Mortality is used, with either 3 per cent or $3\frac{1}{2}$ per cent interest. In our particular case we use the American Table of Mortality with $3\frac{1}{4}$ per cent interest or the American Experience Table of Mortality with $3\frac{1}{2}$ per cent interest, whichever gives the higher reserve. In this particular case we used $3\frac{1}{4}$ per cent interest. We have been using the $3\frac{1}{4}$ per cent rate since January 1, 1935. Prior to that we used $3\frac{1}{2}$ per cent. The rate is determined by the average rate we estimate can be conservatively obtained over a period of years. That is the general practice with all other companies. The rate applicable to a policy throughout its life is stated in the policy.

The cash surrender value is usually lower than the total initial premium paid. The cash surrender value is calculated by taking

a certain percentage of the reserve under the policy and is lower than the reserve in the case of a single-premium policy during the first year that the policy is outstanding.

"Q. 1. Now, what accounts for the difference between the cash surrender value and the reserve? A. Ordinarily, a life insurance policy is issued for the primary purpose of paying a claim later on. It may be a death claim or a matured endowment. If an insured decides that he needs the cash surrender value of his policy and wants to discontinue his insurance, he may surrender the policy and receive whatever cash value is available at that time. If this is done, a charge is composed on the full reserve, and the balance is known as the cash surrender value. A certain part of that reserve is placed in the contingency reserve to take care of adverse mortality fluctuations, and adverse fluctuations in the interest rate. For example, a life insurance (company), probably is not earning three per cent on its new investments, although it guarantees three per cent interest under its policies, or three and one-quarter per cent or three and one-half per cent, depending on the company."

There is a difference in calculating the reserve for life policies and endowment policies. Under the life policy the insurance is payable only upon the death of the insured, so that the reserve we hold at any one time is simply the present value of an amount sufficient to pay this death claim as it falls due. Under an endowment policy there is another element;—not only the death claim to be paid during the endowment period, but also endowment insurance claims to be paid at the end of the endowment period to all those fortunate enough to survive.

The Prudential Policy No. 9114410 contains at the bottom of the second page a provision, under which the reserve for the policy would be figured, which starts as follows: "The cash surrender and loan values set forth in the above table from the third year on, in each case, based on the full reserve according to the Ameri-

can Experience Table of Mortality, with interest at three and one-half per cent. per annum, less a surrender charge ". During the first three-year period the reserve is calculated in exactly the same manner. It is rather a peculiar situation here. It is usual under most ordinary life policies that there isn't any cash value available until the end of three years. However, under the single-premium life and endowment policies there is a cash value available at the end of one year, and that cash value is based on some table of mortality and an interest rate specified in the policy. The situation is exactly the same under the other Prudential policy (No. 9114963). In Connecticut Mutual Policy No. 887777 there is a paragraph headed "Reserves" on what appears to be the second page which covers the basis for calculating the reserves under that policy. In the Mutual Life Insurance Company policy there is a paragraph headed "Reserves" on the third page which covers the basis of calculation of reserves under that policy. In the Fidelity Mutual policy there is a section entitled "Cash Values" on page 4 which covers the basis for the calculation of reserves on that policy. In the Home Life policy on the second page there is a paragraph headed "Reserve Basis" which covers the method of computing the reserve under that policy. The maximum rate at which the computation of the reserve is made on these policies, is $3\frac{1}{2}$ per cent interest and the minimum rate is 3 per cent. The lower the interest rate, the larger will be the reserve. In other words if you set out to accumulate a certain amount of money, the lower the interest rate to be credited each year, the larger the amount you have to invest in order to accumulate that certain amount of money at the end of a certain period.

The loading charges, to which reference has been made, are made up of various items including commissions, taxes, etcetera. The figures reflecting those items do not appear in the reserve. They are in that portion of the overlay above the reserve. There is a provision for expenses in the office premium, which is the difference between the reserve at the outset and the total premium charges. In our case the cash surrender value would be less than

the reserve except that the cash surrender value at the time of the endowment would be the same. During the first year of the policy the cash surrender value would be smaller; that would be true in every case.

"Q. 2. If you should take the four per cent rate in accordance with the tables set out in the regulations and apply it, use that figure in your computation, you would arrive at figures as of the date of the gift, larger or smaller or identical with the cash surrender value of each of these policies? A. Smaller, because they are based on a larger rate of interest.

"Q. 3. And that would bring it below the cash surrender values in each case? A. That is right."

Cross Examination.

The reserve is an asset specifically set aside by the company to meet a liability on a particular policy as it falls due. The reserves constitute the insurance company's investment fund. The company expects, by investing this money, considering the class of claims as a whole, to have enough to be able to pay all claims when they come due.

"Q. 4. Just how do you compute the single premium on life insurance policies, Mr. Cheney? Let us take Prudential Policy No. 9114410, for instance. Do you have any computation showing how you arrive at that single premium? A. Yes, I have. This policy was issued at age 57 on the single payment life plan in the amount of \$100,000 of insurance, the date of issue being December 4, 1935. There are actuarial tables—from the actuarial tables we find that the net single premium for this type of policy at age 57 is \$608.33 per thousand. The net single premium at age 58 is \$620.24 per thousand, or on the basis of \$100,000 of insurance, the figures are respectively, \$60,833 and \$62,024. I find that these policies were in force 26 days before they were transferred as a gift. To find the interpolated reserve . . . we interpolate between reserves at 57 and 58 to find out what the reserve would be

at the end of 26 days after the policy was issued, and we find that the total interpolated reserve as of December 30, 1935 was \$60,917.84."

The reserve immediately after the policy becomes effective is called the initial reserve and the reserve at the end of the policy year is called the terminal reserve. When you wish to determine the amount of reserve in between the initial and terminal reserve, you use the method of the interpolating reserve. To shorten the matter, the single premium charge is worked out on a mathematical formula worked out by the insurance companies on the basis of experience that will give a sum sufficient to maintain the reserve, to pay the insurance agent's commission for writing the policy, and the costs of management of the policy and investments up to the time the claim matures, and other loading charges. That is all comprised in the single premium that is charged the insured for the policy. The reserves increase from year to year as time goes on. At the very outset, the reserve on the policy is invested at a certain rate of interest. At the end of each year that interest is added to the principal, and from that is deducted the cost of insurance for that particular policy for the year. The net result is the reserve under that policy at the end of a year. The reserve increases as a result of these dividend credits which are added at the end of each year. There is a certain time in the life of a single-premium policy where the reserve equals or exceeds the single premium. In general, on single-premium policies, there is a cash surrender value at the end of the first year and each year thereafter.

"The Member: Are there some single premium policies which have no cash surrender value for more than a year after issuance?

"The Witness: There might be some single premium straight term policies which have no cash surrender value at all, or at least until the end of three or five years; but that is not the type of policy we are talking about here today. We are talking about single payment life insurance policies and single payment endowment policies."

By Mr. Head:

Ordinarily, under single-premium policies, there is no cash surrender value until the policy is in force for one year. The cash surrender value is nothing more or less than the reserve for the policy, minus the surrender charge. The surrender charge varies with the different companies and for the different policy years. One of the reasons for the surrender charge is to discourage surrender of the policy. It costs the company money to put the policy on their books and they make their investments accordingly. If the policy is surrendered they are put to the expense of placing that policy again, and there is a possibility of loss—when a policy is surrendered we have to sell securities to get sufficient funds to pay the cash surrender value. In times of stress we may be forced to sell those securities at a loss so that some surrender charge must be imposed. I mean that part of the surrender charge is placed in a contingency reserve for adverse mortality experience and adverse interest experience over a period of years. When a person buys a single-premium life insurance policy, the insurance company contracts that it will immediately set aside a certain amount of reserve and will invest and reinvest that sum and guarantee to the policy-holder the success of those investments, so that when his claim matures he will receive the full face amount of his claim.

"X-Q. 5. Supposing for a moment that instead of the cash surrender value the insurance company would permit the policy holder to surrender his policy in the first year—having taken out that amount of the reserve, it would be impractical for the policy holder to take that reserve and invest it himself over a period of years, and expect to come up at the time the claim would mature with the same amount the insurance company would pay, would it not? A. I think it would be impracticable. As you say, the mortality table anticipates a certain number of deaths during the first year, during the second year and so on. If a man invests a certain amount of money and does not live out the expectation of life, that amount

would not accumulate to the full amount of the insurance at the time of his death, but only on the average. The expectation of life is the average lifetime, beginning at a certain age

"X-Q. 6. In addition, he would have the risks of management, risks of loss; risks of that sort which he does not have in an insurance policy? A. That is right.

"X-Q. 7. So he has a contract with the insurance company which is more valuable than merely the amount of the reserve maintained. Would you say that that is a fair statement? A. Life insurance itself is a cooperative plan whereby a large number of individuals are insured. Insurance is based on the law of averages. It is based on certain rates of interest being earned in the future, certain rates of mortality being experienced, and because of this operation of the law of averages an individual in the group does have more security than if he planned to set up some such premium that would pay this insurance on his own life.

"X-Q. 8. And the cost of this service of management and this guarantee of success of investment so that the policy holder can be assured of getting the full amount of his claim when it matures is included in the amount of the single premium? A. Yes. It is included in there, but, as I said before, it is based on the operation of the law of averages and the spread of risk."

Redirect Examination.

On the day of these gifts none of the six companies would have paid to the owner of any of the policies the amount of reserve against the policies. The figure that our company would have paid would have been the discounted value of the first year cash surrender value, as of the date of the gift. In our case, if you take the cash surrender value of policy No. 9114410 and discount it at $3\frac{1}{2}$ per cent interest the amount of the gift on that policy on that basis would be \$56,076.94. In any case where we do not have an absolute obligation to pay the cash surrender value during the

first year, it is discounted back at the stipulated rate. The one great element increasing the reserve each year as it goes along is the interest earned and credited from year to year. In a sense, the computation of the reserve on a single-premium policy takes into consideration the same elements involved in an annual payment policy, but we do not have to consider the present value of future premiums to be collected under single-premium policies because the full premium has been collected in advance. The difference between the reserve and the cash surrender value on a particular policy is accounted for by the premiums actually paid and the surrender charge under the policy for that particular year.

Thereupon, TRESSLER W. CALLIHAN, a witness called on behalf of the petitioner, being the first duly sworn, testified as follows: I live at 110 Cedar Street, Newton Centre, Massachusetts. My present position is that of general agent in Boston of Home Life Insurance Company of New York. I have been in the insurance business since 1922, starting as an agent, general agent, home office official and I am now running my own office. As home office official, I was connected with the John Hancock Insurance Company. I am now an insurance agent as well as a general agent. In the course of my business I deal generally with life insurance policies. I have frequently arranged for loans on insurance policies, acting on behalf of the policy holder.

I am familiar with the six policies involved in this proceeding and have examined them to see whether they are in such form that they could be readily assigned. They are readily assignable. It would make no difference whether the assignee had an insurable interest in the insured.

Policies are assigned as security for loans. From my experience there have been only two sources from which loans could be obtained on that basis and with that security, banks and insurance companies. At the present time there is a difference in rates as between the two sources. Insurance companies, in general, charge six per cent. It is possible to obtain a lower rate from banks. I have had no experience with private lenders but I know of situa-

tions in which I have not participated in which private lenders have loaned. To my knowledge, insurance policies are not generally bought and sold (as distinguished from loan transactions) except by insurance companies themselves, *i.e.*, in the case of an actual surrender. The cash surrender value and the loan value of a policy, so far as the insurance company is concerned, is identical, except that some companies may deduct the interest charge from the loan at the start. Substantially, the cash surrender value and the loan value is identical. From my experience banks will make loans up to 90 percent of the cash surrender value, and never exceeding the maximum cash surrender value. There are cases where the banks would lend to the full cash surrender value. Never in my experience would a bank lend to any figure in excess of the cash surrender value. I am familiar with various situations in which policies have been assigned, in my experience, for value. I have been engaged in transactions in which policies have been assigned by one person to another. There is a case going through today where an individual is making a loan of \$38,000 on life insurance policies where the cash value just is in excess of \$40,000. The loan is going through a bank and the bank is making this as the limit it will take on this particular contract.

"Q. 1. Have you had any transaction in which the value—whatever the manner for determining it, was in excess of the cash surrender value? A. I have not.

"Q. 2. Have you had any occasion in which it was less than the cash surrender value? A. The case I just mentioned.

"Q. 3. That is a loan? A. Yes.

"Q. 4. But the case of a transfer not involving a loan where there was occasion to determine the value, was it ever determined at a figure other than the cash surrender value? A. Not in my experience."

People quite frequently buy insurance policies for investment. In my experience corporations do not buy them for investments or with the expectation of taking the cash surrender value prior to

maturity; I know of cases where individuals have bought policies for those purposes. In my own experience, in buying policies as investments, we sell them to carry through either to maturity or to death.

"Q. 5. What, Mr. Callihan, in your experience, is the highest amount a person may obtain for an insurance policy?

A. The cash surrender value."

Cross Examination.

"X-Q. 6. Mr. Callihan, you never knew the banks to make a practice of loaning money over the full amount of the value of the collateral on anything, did you? A. Well, I have seen it done, yes.

"X-Q. 7. You have? What was the transaction, if you will give us the details? A. Government bonds.

"X-Q. 8. You have seen a bank lend 100 per cent on a government bond? A. In one instance.

"X-Q. 9. That is interesting. When did that transaction occur, and what were the circumstances? A. It was a personal loan.

"X-Q. 10. To one of the bank officials? A. To yours truly, to myself.

"X-Q. 11. Mr. Callihan, do you wish to tell his Honor by your testimony that an insurance policy is not worth what the company sells it for? A. I will answer the question this way: that in dollars and cents, from the standpoint of the individual who purchases the policy, at the time he purchases it if he wanted to get back immediately the amount of money he put into the contract, it is not worth what he put into it because he cannot get that money back.

"X-Q. 12. But you do not wish to tell his Honor that a contract of insurance a policy holder purchases from a company is not worth fully what the company charges him for? A. If we figure the protection. We feel that in buying the protection, he has paid for so much for protection on the contract."

"X-Q. 13. On direct examination you were confining yourself to what the policy holder could realize on a policy on a forced sale or a loan? A. I should not say a forced sale. Sometimes they take cash surrender value not on a forced sale; what they could realize if they wanted the cash immediately."

Thereupon, HENRY K. WHITE, a witness called on behalf of the petitioner, after being first duly sworn, testified as follows:

I live at 250 Beacon Street, Boston. I am assistant cashier, First National Bank, Boston. My duties as an officer of the bank include passing on loans, including loans on insurance policies. Generally speaking, loans are made on insurance policies up to 90 per cent of the cash surrender value which is available at the time the loan was made. In determining that figure we take into consideration the credit of the borrower to the extent that on a 90 per cent basis the credit of the borrower is considered only with relation to the term for which the loan is required or may be carried. From the point of actual protection to the bank, the moral hazard is not a factor.

"Q. 1. Do you—does the bank ever loan in excess of the cash surrender value of the policy? A. In a transaction where the possible death benefits of the policy are considered.

"Q. 2. That is—will you explain that a bit? A. There are loans that may be made to an individual or a corporation which are secured by life insurance policies. We consider that the maker is good so long as he lives and will repay without necessarily having to put up any liquid collateral. On the other hand, in the event of his death, because he may be an important officer in the corporation, or merely an individual borrowing in his own name, he might not be able to pay the note, and therefore the protection to the bank is given in the form of death benefits payable under the policy.

"Q. 3. Where the only element involved is the adequacy of the collateral and the only collateral given is the insurance

policy, do you ever loan in excess of the cash surrender value?
A. No, sir."

I am familiar with the general practice in New England with respect to this type of transaction. The practice conforms to the policy of our bank as above testified. Loans by banks on insurance policies are becoming more common.

"*Q.* 4. What relation do the interest rates which the banks normally charge on this type of loan bear to the 6 per cent rate stipuated in the policy? *A.* At the present time the rates are approximately half, but that depends somewhat on the nature of the transaction.

"*Q.* 5. Is that a consideration having some bearing on this type of transaction in the banking business? *A.* I believe it has."

Cross Examination.

"*X-Q.* 6. In making loans, the bank ordinarily is concerned primarily with security, is it not? *A.* Yes.

"*X-Q.* 7. And it is not the ordinary practice of the bank to loan up to the full value of the collateral deposited for a loan? *A.* No.

"*X-Q.* 8. The bank, ordinarily, fixes collateral at the amount which they believe they could realize if they had to liquidate it immediately? *A.* Yes."

Rédirect Examination.

"*Q.* 9. Mr. White, in determining the amount which a bank will lend on an insurance policy, does the bank give any consideration to the reserve behind that policy? *A.* Yes, almost entirely.

"*Q.* 10. And, by reserve, you mean what? *A.* The cash surrender value.

"*Q.* 11. And does the bank give consideration to any figure other than the cash surrender value? *A.* No, other than in the type of commercial transaction where the death benefit is the principal factor of security."

We are willing to loan up to 90 per cent of the cash surrender value because we know there is security in the cash surrender value itself which will enable the bank to pay the loan if it is in default.

The foregoing evidence is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, as attorney for the Commissioner of Internal Revenue.

J. P. WENCHEL, RLW,
Chief Counsel, Bureau of Internal Revenue.

The foregoing is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned, as attorney for the respondent on review.

RALPH G. BOYD,
Attorney for Respondent on Review.

This statement of evidence is duly approved and settled this twenty-ninth day of November, 1939.

J. M. STERNHAGEN, *Member,*
United States Board of Tax Appeals.

[Title omitted.]

PRAECIPE FOR RECORD.

[Filed November 28, 1939.]

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the clerk of the United States Circuit Court of Appeals for the First Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the First Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board,

- (a) Petition, including annexed copy of deficiency notice.
- (b) Answer.

3. Memorandum findings of fact and opinion, and decision of the Board.

4. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

5. Statement of evidence as settled and allowed.

6. Stipulation of facts filed May 16, 1938.

7. Orders enlarging time for the preparation of the evidence and for the transmission and delivery of the record.

8. This praecipe.

J. P. WENCHEL, RLW

Chief Counsel, Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted this thirteenth day of November, 1939. No counter-praecipe to be filed.

RALPH G. BOYD,

Attorney for Respondent on Review.

[Title omitted.]

CERTIFICATE.

I, B. D. Gamble, clerk of the United States Board of Tax Appeals, do hereby certify that the foregoing [typewritten] pages, 1 to 49, inclusive [printed pages 1 to 39, inclusive] contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this second day of December, 1939.

B. D. GAMBLE, *Clerk,*

United States Board of Tax Appeals.

[SEAL]

[MEMORANDUM. Orders of enlargement of time for docketing case to, and including, December 28, 1939, are here omitted. A. I. CHARRON, *Clerk*.]

ORDER OF CIRCUIT COURT OF APPEALS.

November 16, 1939.

Upon motion of petitioner for review, assented to, leave is granted to transmit five copies each of Petitioner's Exhibits 1 to 6, inclusive, and Respondent's Exhibit A, as physical exhibits, in lieu of reproduction thereof in the printed record on petition for review.

By the Court,

ARTHUR I. CHARRON, *Clerk*.

[fol. 41] On April 17, 1940, this case was argued and was fully heard by the Court, Honorable Calvert Magruder and Honorable John C. Mahoney, Circuit Judges, and Honorable George C. Sweeney, District Judge, sitting.

Thereafter, to wit, on July 16, 1940, the following Opinion of the Court and Concurring Opinion were filed:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST
CIRCUIT, OCTOBER TERM, 1939

No. 3546

COMMISSIONER OF INTERNAL REVENUE, Petitioner for Review,

v.

MADELEINE D. POWERS

Petition for Review of a Decision of the United States
Board of Tax Appeals

Before Magruder, Mahoney and Sweeney, JJ.

OPINION OF THE COURT—July 16, 1940

SWEENEY, J.:

This case is before us on the petition of the Commissioner of Internal Revenue to review a decision of the Board of Tax Appeals, entered January 9, 1939, in which that Board ruled that there was no deficiency in the gift tax paid by the respondent for the year 1935.

In late November and early December, 1935, the respondent Madeleine D. Powers purchased six single premium policies of insurance as follows:

[fol. 42] Company and policy number	Date of issue of policy	Name of insured	Face amount of policy	Amount of single premium paid	Type of policy
The Fidelity Mutual Life Ins. Co., No. 532838	11/25/35	Madeleine D. Powers	\$20,000	\$13,967.40	Ordinary Life
The Prudential Ins. Co. of America, No. 9114410	12/ 4/35	Madeleine D. Powers	100,000	68,779.00	Ordinary Life
The Mutual Life Ins. Co. of N. Y., No. 5090777	11/25/35	Madeleine D. Powers	40,000	27,204.80	Ordinary Life
The Prudential Ins. Co. of America, No. 9114963	12/ 5/35	Madeleine Powers	122,000	99,672.78	10-Yr. Endowment
The Connecticut Mutual Life Ins. Co., No. 887777	11/27/35	Madeleine Powers	28,000	22,671.60	10-Yr. Endowment
Home Life Ins. Co. No. 435395	11/27/35	Madeleine Powers	50,000	40,854.00	10-Yr. Endowment

In the policies on the life of Madeleine D. Powers, George H. Powers was named as the beneficiary, if living. In the policies on the life of Madeleine Powers, the respondent's daughter, the beneficiary was Madeleine D. Powers, if living; otherwise they were payable to the insured, the estate of the insured or the estate of the respondent. On December 30 and 31, 1935, the respondent made gifts of the policies in the form of irrevocable assignments to the respondent's husband and the Massachusetts Hospital Life Insurance Co., as trustees. At the time of the respective gifts the policies had cash surrender values and reserves carried against them as follows:

Company and policy number	Date of gift	Cash surrender value on date of gift	Reserve carried by Ins. Co. at date of gift
The Fidelity Mutual Life Ins. Co., No. 532838	12/30/35	\$12,360.00	\$12,672.02
The Prudential Ins. Co. of America, No. 9114410	12/30/35	56,198.86	60,917.84
The Mutual Life Ins. Co. of N. Y., No. 5090777	12/30/35	*23,271.30	25,344.05
The Prudential Ins. Co. of America, No. 9114963	12/30/35	84,067.70	89,383.33
The Connecticut Mutual Life Ins. Co., No. 887777	12/30/35	20,790.73	21,126.73
Home Life Ins. Co., No. 435395	12/31/35	36,671.71	37,728.33

* Cash surrender value when right to surrender first arose, discounted to date of gift.

[fol. 43] The only question in the case is the value of the policies on the date of the transfer to the trustees. The respondent contends that the value of the policies for gift tax purposes was the cash surrender value on the date of the transfer, and points to Article 2(5) of Treasury Regulations 79, promulgated under the Revenue Act of 1932, as her authority. Article 2(5) reads as follows:

"Transfers Reached: * * * In the following examples of transactions resulting in taxable gifts * * *

"(5) The irrevocable assignment of a life insurance policy, or the naming of the beneficiary of a policy without retaining any of the legal incidents of ownership therein, constitutes a gift in the amount of the net cash surrender value, if any, plus the prepaid insurance adjusted to the date of the gift."

The Commissioner contends that Article 2(5) is invalid in view of Article 19 of the same Regulations, which reads as follows:

“Valuation of property.—(1) General.—The statute provides that if the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift. The value of property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell. Where the property is sold within a reasonable period after the date of the gift, and it is shown that the selling price reflects the fair market value thereof as of the date of the gift, the selling price will be accepted as the amount of the gift. All relevant facts and elements of value should be considered in every case.”

He argues that Article 19 deals exclusively with the valuation of property, and that any inconsistency between Article 2(5) and Article 19 must be resolved in favor of Article 19. There is an inconsistency between Article 2(5) and Article 19 of Regulations 79, and it seems inevitable that Article 2(5), which was written in under a heading “transfers reached”, must give way to Article 19 which is under a heading “valuation of property”, unless the word “value” as used in the Act can mean only cash surrender value, and [fol. 44] nothing else, as applied to insurance. The language of the Act does not warrant such an interpretation since it deals generally with property, and states that the value of a gift shall be considered to be the amount of the gift. Any attempt on the part of the Commissioner to promulgate a regulation which would establish a different value than that imposed by the Congress in enacting the taxing statute would be invalid. It is to be noted that when Regulations 79 were amended in 1936, Article 2(5) was amended by omitting reference to value, and by stating that the value of insurance policies was covered in Article 19(9). As will appear herein later, we reach the conclusion that insofar as Article 2(5) of Regulations 79 is applicable to single premium life insurance policies it is not consistent with the language of the Act, and would be an arbitrary and unreasonable attempt to set a valuation that is not a true one. See *Lynch v. Tilden Co.*, 265 U. S. 315; *Miller v. United States*, 294 U. S. 435.

Many of the decisions that have held that the cash surrender value of an insurance policy is the true value of a gift of such a policy follow the reasoning in *Commissioner v. Haines*, 104 F. (2d) 854. In that case it was stated

that since Article 2(5) of Regulations 79 remained the same throughout 1934 and 1935, and received Congressional approval by the reenactment of Section 506 in the taxing statutes of 1934 and 1935, that Article 2(5) had "the force of law", citing *Helvering v. R. J. Reynolds Company*, 306 U. S. 110. See also *Helvering v. Cronin*, 106 F. (2d) 907, and *Helvering v. Bryan*, 109 F. (2d) 430. A close reading of the taxing statutes of 1934 and 1935 does not disclose that Section 506 of the 1932 Act was in fact reenacted in either of these years but was left unchanged.

In 1936, Article 19(9) was adopted, which reads as follows:

"(9) *Life insurance and annuity contracts.*—The value of a life insurance contract or of a contract for the payment of an annuity issued by a company regularly engaged in the selling of contracts of that character is established through [fol. 45] the sale of the particular contract by the company, or through the sale by the company of comparable contracts. As valuation through sale of comparable contracts is not readily ascertainable when the gift is of a contract which has been in force some time and on which further premium payments are to be made, the value may be approximated, unless because of the unusual nature of the contract such approximation is not reasonably close to the full value, by adding to the interpolated terminal reserve at the date of the gift the proportionate part of the gross premium last paid before the date of the gift which covers the period extending beyond that date.

"The examples given below, so far as relating to life insurance contracts, are of gifts of such contracts on which there are no accrued dividends or outstanding indebtedness.

* * * * *

"Example: A donor owning a life insurance policy on which no further payments are to be made to the company (e. g., a single premium policy or paid-up policy) makes a gift of the contract. The value of the gift is the amount which the company would charge for a single premium contract of the same specified amount on the life of a person of the age of the insured."

Since the application of Article 2(5) of Regulations 79 (1932 Ed.) to these policies would effect a result different than intended by Congress, we must disregard it, and it

follows that Article 19 of the 1932 Regulations as amended by Article 19(9) of the 1936 Regulations must prevail. See *Manhattan Company v. Commissioner*, 297 U. S. 129. It does not seem necessary, however, to turn this case entirely on the construction of any of the Regulations. Section 506 of the Revenue Act of 1932, c. 209, 47 Stat. 169, 26 U.S.C.A., § 555, is as follows:

“SEC. 506. Gifts made in property.

“If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.”

In reaching a determination of what the value means as applied to single premium policies, we must bear in mind that we are dealing with a particular type of property which may be subject to somewhat different rules than [fol. 46] would apply to most forms of property. The value of a single premium life insurance policy must mean the fair market value, if there is such a value, and, in any instance, must be based upon a consideration of all of the relevant facts and elements.

The Board below has found that the cash surrender value of a policy is an arbitrary figure arrived at by the insurer by deducting from the reserve set up under the policy a so-called surrender charge. It is for the purpose of discouraging surrender of the policy that this charge is made. We do not think that the cash surrender value of a policy on any given date is necessarily its real value within the meaning of Section 506. See *Lucas v. Alexander*, 279 U. S. 573. See, also, *Guggenheim v. Rasquin*, 110 F. (2d) 371. It is unfair to contend that the cash surrender value is the true value of a single premium life insurance policy merely because that happens to be the amount that the insurance company would give to be released from its contract. Such a contention confuses a forced liquidation for an arbitrary figure, with an assumed market in which insurance policies of this type are bought and sold.

In the strict sense of the word, insurance policies once issued and fully paid for are not bought and sold in an open market. At least, there are no published quotations of values of such policies on any given date. It would be much fairer to ask what the insurance company, which is in the business of selling insurance and not buying, would sell a similar contract for on the date of transfer where

the conditions of issuance were the same. The fallacy of the proposition that the cash surrender value is the true value of these policies can be demonstrated by recourse to one of them. In policy No. 9114410, the Board found that there was no "absolute obligation to pay the cash surrender value during the first year", but that the Prudential Life Insurance Company "would have granted the discounted value of the first year cash surrender value, as of the date of the gift". If the insurer was under no obligation to pay any cash surrender value during the first [fol. 47] year, it could be assumed that it might refuse to discount the value at the end of the first year. This would mean that the policy would have no cash surrender value as of the date of the transfer. Could it be argued successfully that the gift of this policy about a month after its issuance would be the gift of a thing having no value? We do not think so.

A single premium insurance policy is unlike most property which is made the subject of a gift, in that it seems to have no depreciation. On the day that these policies were issued their value was the price that was paid for them. *Guggenheim v. Rasquin*, supra. This is demonstrated by recourse to the familiar rule for determining fair market value, namely, what a willing buyer would pay to a willing seller for an article where neither is acting under compulsion. If the value of the policies on the date of issuance was the cost, what has happened to decrease that value? To effect a decrease there must be some intervening factor or element which would have a direct relation to its value. In many types of insurance the uncertainty of the ability to pay further premiums may affect that value, but in the instant case all premiums have been paid. Nothing but the passage of time is needed to increase their value to the higher face value of the policies. Certainly there has been no decrease in the value of the policies. In other words, the value of these policies, starting out on the dates of issue, as equivalent to their cost, can only increase as time passes.

It is a well-recognized fact that the cost of insurance increases with the age of the insured. This undoubtedly is because as an insured grows older his life expectancy is shorter, and the ability of the company to earn sufficient on the reserve to pay the face of the policy at its contemplated maturity is more limited. While premiums are usually recomputed only every six months, nevertheless,

actuarial tables, it is presumed, could show an actual daily increase in the hazard. The Board below found that the reserves set up under policy No. 9114410 increased from \$60,833 to \$60,917.84 during the twenty-six days between [fol. 48] the date of issuance and the date of transfer of that policy. This was undoubtedly brought about either through its earnings or through reallocation of reserves. These facts are inconsistent with a decrease in the value of a single premium policy after its date of issue, and since, in our opinion, the court in *Guggenheim v. Rasquin*, supra, correctly held the value of a policy at the date of issue to be the cost of the policy and not its surrender value, it necessarily follows that the true value of a policy transferred shortly after the date of issue would be the cost of a similar policy on that date, and not its lower cash surrender value, which the taxpayer claims to be the proper measure of value.

We therefore reject the theory that the cash surrender value of the policies, or even the reserves of the policies, was the test of their value on the date of transfer, and think that the Commissioner assessed the tax on the minimum proper basis, namely, the cost of the policies to the donor.

The decision of the Board of Tax Appeals is reversed, and the case is remanded to the Board for further proceedings not inconsistent with this opinion.

Magruder, J., concurring. The statute does not define "value", but merely provides that if the gift is made in property "the value thereof at the date of the gift shall be considered the amount of the gift". It is not clear to me that the cash surrender value test stated in Article 2(5) of Regulations 79 (1932 ed.) is invalid as in conflict with the statute. Nor is it clear to me that the specific provision in Article 2(5) (1932 ed.) dealing with this particular species of property is inconsistent with the general provisions of Article 19(1) of the same edition of the Regulations. But the provisions of the 1932 edition of the Regulations, as applied to gifts of insurance policies, were at best unclear and confusing (see *Guggenheim v. Rasquin*, 110 F. (2d) 371, 373), and the Commissioner quite properly clarified the Regulations in the 1936 edition. The Commissioner's regulations are merely persuasive guides for the courts in interpreting the revenue acts and, at least, in the absence of an intervening reenactment by Congress

(*Helvering v. Reynolds Co.*, 306 U. S. 110, 116), the courts are free to adopt and apply retroactively a later regulation clarifying and modifying an earlier interpretation. In this case the regulation as amended in 1936 certainly gives a permissible interpretation of the act. Indeed, having in view the peculiar nature of single premium life insurance policies as "property", I think the later interpretation is the more reasonable one, as the opinion of the court demonstrates.

On the same date, to-wit, July 16, 1940, the following Final Decree was entered:

FINAL DECREE—July 16, 1940.

This cause came on to be heard April 17, 1940, upon the record on petition for review of the United States Board of Tax Appeals, and was argued by counsel.

Upon consideration whereof, It is now, to-wit, July 16, 1940, here ordered, adjudged and decreed as follows: The decision of the Board of Tax Appeals is reversed, and the case is remanded to the Board for further proceedings not inconsistent with the opinion passed down this day.

By the Court.

Arthur I. Charron, Clerk.

Thereafter, to-wit, on July 31, 1940, on motion, mandate was stayed until further order of court.

[fol. 50]

CLERK'S CERTIFICATE

I, Arthur I. Charron, Clerk of the United States Circuit Court of Appeals for the First Circuit, certify that the foregoing pages numbered 1 to 49, inclusive, contain and are a true copy of the record and all proceedings to and including September 23, 1940, in the cause in said court numbered and entitled, No. 3546, Commissioner of Internal Revenue, Petitioner for Review, v. Madeleine D. Powers.

In testimony whereof, I hereunto set my hand and affix the seal of said United States Circuit Court of Appeals for the First Circuit, at Boston, in said First Circuit, this twenty-third day of September, A. D. 1940.

Arthur I. Charron, Clerk. (Seal United States Circuit Court of Appeals, First Circuit.)

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI.—Filed November 12, 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the First Circuit is granted, and the case is assigned for argument immediately following No. 92.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(1676)